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WAS THE WASHINGTON AREA ECONOMY EVER RECESSION PROOF?

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Preface

The purpose of this monograph is to test the assumption that the Washington Area is recession proof by examining the impact of the 1974-75 and the 1980-81 recessions on key economic indicators in the Area.*

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*TECHNICAL NOTE: The current national recession started officially in July of 1981 and has not abated as of press time (August 1982). However, because of the need for a reference period for the purpose of comparative analysis, we will refer to this current recession as the 1980-81 recession, utilizing available data for calendar years 1980 and 1981. Similar data for 1982 are not yet available. Such data, when available, is expected to reveal even sharper declines in referenced economic indicators (a result of recessionary impact) than available data indicate.

WAS THE WASHINGTON AREA ECONOMY EVER RECESSION PROOF?

Since World War II, the U.S. economy has experienced eight recessions. These recessions were generally characterized by declining incomes, employment, and output; and rising unemployment (level and rate) in varying degrees. In addition, business and consumer optimism had fallen, resulting in declining rates of capital investment and consumption.

Because of the significant presence of the Federal Government in the Washington Metropolitan Area, many have assumed until recently that this Area's economy is largely unaffected by national recessions. Such thinking has created a belief often quoted in the media, i.e., "The Washington Area economy is recession proof." The impact of the current recession on the local economy has cast some doubt on this long-standing assumption. Using available data, this paper will examine the impact of the two most recent major recessions (1974-75 and 1980-81) on key economic indicators in the Washington, D.C. SMSA.

We will begin our analysis by looking at the key economic indicators in the Washington Area and the probable effects that a recession would have on them if the Area economy is not recession proof (Table I). Then we will analyze the impact that the two recessions actually had on Area economic indicators to determine just how recession proof they really are. If the Area economy is recession proof, then the recessions should have little or no significant impact on the economic indicators. Moreover, the greater the negative impact, the greater the reason to question the validity of the recession proof assumption.

Table I

The Probable Effects of Recession on Economic Indicator in the Washington, D.C. SMSA

Economic Indicators	Effect	
	Decline	Rise
Gross Product, Real	x	
Unemployment Rate and Level		x
Housing Starts	x	
Value of New Contruction	x	
Industry Employment, Private	x	
Industry Employment, Public		x
Per Capital Income, Real	x	
Retail Sales, Real	x	

Source: D.C. Department of Employment Services
Division Labor Market Information,
Research and Analysis

From Table I we can see that in an economy assumed vulnerable to recessions, all selected economic indicators decline during a recession, except for the level and rate of unemployment and the level of public employment[1/] (which would tend to rise).

Now let's look at Table II to see what impact the 1974-75 recession actually had on the Washington Area economy. Of the nine economic indicators listed, six responded positively to our "test":

1. The level of unemployment increased 32.4 percent.
2. The rate of unemployment increased 1.1 percentage points.
3. The number of housing starts declined 47.5 percent.
4. The value of new contruction declined 36.6 percent.
5. Private employment declined 1.4 percent.
6. Public employment increased 3.5 percent.

The impact of the 1974-75 recession was most pronounced on housing starts and the value of new construction,[2/] measures of capital investment. Adjusting the value of new construction for price changes, using the Consumer Proce Index (CPI) for the Washington Area, the drop between 1974 and 1975 was even sharper at 41.2 percent. Housing starts dropped by 8,700 between 1974 and 1975—a 48 percent decrease.

Unemployment in the Area also increased sharply during the 1974-75 recession. In 1975, there were 18,300 more unemployed Area residents (an increase of 32.4 percent) than the previous year for a total of 74,800. Likewise, the

1/ In the past it has been government policy to counteract slowdowns and downturns in economic activity by increasing government spending and employment (often referred to as Keynesian economic policy).

2/ These figures include the value of residential and nonresidential contruction only.

Table II

The Impact of the 1974-1975 Recession of Key Economic Indicators in the Washington, D.C. SMSA

Economic Indicator	1974	1975	Absolute Difference	Percent Change
Gross Product, Real*	$12,379.2	$13,263.1	$883.9	7.1
Unemployment, Level	56,500	74,800	18,300	32.4
Unemployment, Rate	4.1	5.2	1.1	26.8
Housing Starts	18,300	9,600	-8,700	-47.5
Value of New Construction million	725.4	459.8	-265.6	-36.6
Industry Employment Private (000)	833.2	821.2	-12.0	-1.4
Industry Employment Public (000)	502.8	520.4	17.6	3.5
Per Capital Income, Real	$4,777.3	$4,829.2	51.9	1.1
Retail Sales, Real 1/* million	$5,377.3	5462.9	85.6	1.6

* Millions

Source: D.C. Department of Employment Services
Division of Labor Market Information,
Research and Analysis

1/ Retail Sales data for 1974 and 1975 is not strictly comparable to the 1980 and 1981 retail sales data.

unemployment rate increased sharply (1.1 percentage points) to 5.2 percent in 1975.

Reflecting depressed capital investment (spending by businesses) and higher levels and rates of unemployment, private industry employment declined 1.4 percent between 1974 and 1975 in the Metropolitan Area. This 1.4 percent decline resulted in 12,000 fewer jobs in the private sector. By no means, though, were these losses in industry employment distributed evenly among the various industry groups. Feeling the pinch of lower capital investment, Contruction and Finance, Insurance, and Real Estate employment declined by 16,000 and 2,500 respectively during the recession. Other industry groups which declined during this period were Transportation, Communications, and Public Utilities (2,000); and Manufacturing (1,400) while Trade and Services employment increased by 2,900 and 5,100 respectively.

The counter-cyclical nature of government employment was quite evident during this period increasing 3.5 percent, adding an additional 17,600 jobs to the Area's economy. The result of this increase in Government employment was a net increase in total industry employment from 1,336,000 in 1974 to 1,341,600 in 1975.

The other indicators (gross product, retail sales, and per capita income) were more resistant to the impact of the 1974-75 recession. The gross product, which measures the value of all goods and services produced in the Area, showed the greatest ability to adjust to the recession. Over the course of the recession the gross product rose 7.1 percent in real dollars. During

the decade of the 1970's the gross product increased at an average annual rate of 3.1 percent in real terms. A contributing (if not significant) factor in this increase in the gross product in 1974-75 was the increase in government employment and spending.

The increased government employment and spending also tended to reduce the recession's impact on retail sales, which increased 1.6 percent in real dollars, and real per capita income, which increased 1.1 percent. Comparable historical data on retail sales is not available for the Washington Area for the 1970's. Available data on per capita income in the Metro Area revealed that real per capita income increased at an annual rate of 2.7 percent between 1970 and 1979. Thus real per capita income growth during the recession (1974-75) was less than half the growth rate for the period 1970-79, perhaps indicating some degree of recessionary impact.

This analysis of key economic indicators suggests that the impact of the 1974-75 recession was rather severe in many sectors of the Area's economy, while increased government employment and spending mitigated recessionary impact in other sectors.

The impact of the 1980-81 recession is outlined in Table III. During this recession, five of the nine economic indicators exhibited signs of recessionary impact:

1. The level of unemployment increased 18.2 percent.
2. The rate of unemployment increased 0.8 percentage point.

Table III

The Impact of the 1980-1981 Recession on Key Economic Indicators in the Washington, D.C. SMSA

Economic Indicators	1980	1981	Absolute Difference	Percent Change
Gross Product, * Real	$20,997.4	$21,333.4	$336.0	1.6
Unemployment, Level	72,600	85,800	13,200	18.2
Unemployment Rate	4.3	5.1	.8	18.6
Housing Starts	18,100	15,800	-2,300	-12.7
Value of New Contruction*	$1,369.1	$1,328.3	-40.8	-3.0
Industry employment, Private (000)	1,032.9	1,054.9	22.0	2.1
Industry Employment, Public (000)	559.6	547.6	-12.0	-2.1
Per Capita Income,* Real	$5,259.9	N/A	N/A	N/A
Retail Sales 1/, Real*	$6.3	$6.0	$-.3	-4.8

*Millions

Source: D.C. Department of Employment Services, Division of Labor Market Information, Research and Analysis.

1/ Retail sales data for 1980-1981 is not strictly comparable to the 1974-1975 retail sales data.

3. Housing starts decreased 12.7 percent.
4. The value of new construction decreased 3.0 percent.
5. Retail sales (real) dropped 4.8 percent.

During the 1980-81 recession unemployment showed the sharpest movement, rising 18.2 percent to a level of 85,800. Similarly, the unemployment rate was also up significantly (0.8 percentage point) averaging 5.1 percent during 1981. The recession's impact on the housing market and capital investment mirrored the national trend as both indicators declined. Between 1980 and 1981, housing starts in the Area declined 12.7 percent, while the value of new contruction dropped 3.0 percent. The number of housing starts in 1981 was 2,300 fewer than the 18,100 in 1980. Adjusting the value of new contruction for price changes using the Consumer Price Index for the Washington, D.C SMSA, the relative drop in the value of new contruction between 1980 and 1981 was 14.6 percent.

Retail sales, which are influenced by not only income but also consumers' expectations, consumption patterns, and their willingness and ability to draw down savings, dropped between 1980 and 1981 in real terms. In real terms retail sales in the Washington, DC SMSA dropped 4.8 percent during the 1980-81 recession. Available data indicate the decline in real retail sales was solely the result of decreases in the nondurable goods category with durable goods sales remaining constant between 1980 and 1981. A more comprehensive analysis of these two categories is needed to ascertain (a) whether the declines in nondurable goods was across the board, and

(b) if all sectors within durable goods remained unchanged over the year. This information will aid us in determining more precisely how consumers altered their consumption patterns to achieve lowered retail purchases in real terms.

Three economic indicators for which data are available did not move in the direction expected during the 1980-81 recession: private industry employment; public industry employment; and the gross product.

Between 1980 and 1981, private industry employment rose by 2.1 percent. During 1981, the private sector added 22,000 more jobs to the Area's economy than the previous year (with the exception of the cyclically sensitive Construction industry, which declined by 5,300). All other private industry groups advanced between 1980 and 1981. The gains in the private sector ranged from 300 in Manufacturing to 16,800 in Services.

Government employment in the Washington, D.C. SMSA has not fallen since the 1957-58 recession, when it fell by 3,300. Between 1980 and 1981, though, government employment in the Area dropped 2.1 percent—12,000 fewer government jobs. (Of course, some of the reduction in government employment was caused by budget cuts and other tools of fiscal austerity.) One result of the reduction in government employment was a dampening effect on the increase in total industry employment. Although private industry employment increased by 22,000 jobs between 1980 and 1981, the net increase in total industry employment was held to 10,000 jobs due to the decline in goverment employment.

In 1981, the gross product for the Washington Area advanced 1.6 percent. This rate of growth (during the 1980-81 recession) is just over half the annual rate of 3.0 percent between 1970 and 1980.

It appears, then, that both recessions had a significantly negative impact on certain sectors (basically the same sectors in each case), while other sectors were only mildly affected.

This brief analysis of various key economic indicators during the 1974-75 and 1980-81 recessions indicates that the Washington Area economy is not—and possibly never was—recession proof. (See Table IV for an analysis of the relative changes in the economic indicators during the respective recessions.) An interesting distinction between the 1974-75 and 1980-81 recessions is the difference in government policy. During the economic slowdowns in the 1960's and 1970's, it was government policy to prime up the economy (locally and nationally) by increasing employment and spending. This policy, particularly in the Washington area, tended to lessen the impact of the recessions on industry employment, retail sales (in real terms), real per capita income, and the real gross product. During the 1980-81 recession, however, government employment was reduced[3/], contributing to lower consumer confidence in the economy, declining retail sales (in real terms), relatively higher unemployment, and a relatively smaller increase in the value of all goods and services (gross product) produced in the Washington, DC SMSA.

3/ The level of government employment was not so much a victim of the recession as it was a victim of government policy.

Table IV

Comparative Analysis of the Relative Impacts of the 1974 - 1975 and 1980 - 1981 Recessions on the Washington, D.C. SMSA

Economic Indicators	Percent Change 1974-1975	Percent Change 1980-1981
Gross Product, Real	7.1	1.6
Unemployment Level	32.4	18.2
Unemployment Rate	26.8	18.6
Housing Starts	-47.5	-12.7
Value of New Construction	-36.6	-3.0
Industry Employment, Private	-1.4	2.1
Industry Employment, Public	3.5	-2.1
Per Capita Income, Real	1.1	N/A
Retail Sales [1/]	9.4	7.7
Retail Sales, [1/] Real	1.6	-4.8

Source: D.C. Department of Employment Services, Division of Labor Market Information, Research and Analysis.

In conclusion, we feel that it was probably never accurate to characterize the Washington Area economy as "recession proof." We believe that the local economy is probably best characterized as being relatively resistent to economic downturns—the degree of resistence being a factor of government employment stability in the Washington area.